Supreme Court, U.S.
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1993

MARY SUSAN MATTHEWS,

Petitioner

VS.

UNITED STATES OF AMERICA,
NATIONAL HEALTH SERVICE CORPS,

Respondent

PETITION FOR WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF
APPEALS FOR THE THIRD CIRCUIT

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QUESTIONS PRESENTED

1. Whether the Court of Appeals could properly find that, in a bankruptcy proceeding, nondischarge of your Petitioner's scholarship obligation to the National Health Service Corps would not be unconscionable pursuant to 42 U.S.C. § 254*o*(d)(3)(A) because she was offered the option of fulfilling her service obligation even at the time of appeal to the Court of Appeals when this option was never presented to the Bankruptcy Court, as a general policy or otherwise, before the record was closed.

2. Whether the Bankruptcy Court erred, as the Court of Appeals found, by reducing the nondischargable portion of the amount payable for breach of your Petitioner's service obligation by half — from approximately $400,000.00 to approximately $200,000.00 on a student loan of $46,726.00 — because your Petitioner did not demonstrate that she could not increase her net income by changing her practice or relocating to a higher paying area or reducing her expenses.

3. Whether your Petitioner's significant and critical services provided to an approved clinic in a professional shortage area different from that designated by the Government could be considered by the bankruptcy court as a relevant factor in its determination of unconscionability.

PARTIES TO THE PROCEEDING

Your Petitioner, Mary Susan Matthews was the Appellee in the proceedings in the United States Court of Appeals for the Third Circuit, which proceeding was docketed in that Court at No. 93-3401; and the United States of America, National Health Service Corps, was the Appellant. Listed in the caption in the proceedings of the Court of Appeals but not participating there or in this Court are William Pineo, Esq., the Bankruptcy Trustee in the Chapter 7 bankruptcy proceeding filed by your Petitioner, and also First Eastern Bank, Hahnemann University, and Pennsylvania Higher Education Assistance Agency, which had extended separate student loans sought to be discharged by your Petitioner in the bankruptcy proceeding.

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MARY SUSAN MATTHEWS,

Petitioner

VS.

UNITED STATES OF AMERICA,
NATIONAL HEALTH SERVICE CORPS,

Respondent

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

The Petitioner, Mary Susan Matthews, respectfully prays that a Writ of Certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Third Circuit, which judgment and opinion was entered in this case on March 15, 1994.

OPINIONS BELOW

The March 15, 1994, opinion of the United States Court of Appeals for the Third Circuit at No. 93-3401, the judgment of which is here sought to be reviewed, is reported at 19 F.3d 121. The June 11, 1993, Order of the United States District Court for the Western District of Pennsylvania at Civil Action No. 93-38 Erie, which Order affirmed the determination of the United States Bankruptcy Court, is unreported. Two opinions and orders were issued by the United States Bankruptcy Court. By opinion and order dated December 30, 1992, the United States Bankruptcy Court for the Western District of Pennsylvania determined that one-half of the student loan owed to the National Health Service Corps would be discharged, this being conditioned upon the Petitioner's making satisfactory payment arrangements for the half for which she would still be obligated; this opinion is reported at 150 B.R. 11. By memorandum and order dated January 19, 1993, the Bankruptcy Court refused the motion for reconsideration filed by the National Health Service Corps; this memorandum has not been reported. All these opinions and orders are reproduced in the appendix.

JURISDICTION

The Judgment of the Court of Appeals was entered on March 15, 1994. The jurisdiction of this Court is invoked pursuant to 28 U.S.C. §1254(1).

STATUTORY PROVISION INVOLVED

This case involves 42 U.S.C. § 254*o* (d) (3) (A), which states as follows:

Any obligation of an individual under the Scholarship Program (or a contract thereunder) or the Loan Repayment Program (or a

contract thereunder) for payment of damages may be released by a discharge in bankruptcy under Title 11 only if such discharge is granted after the expiration of the five-year period beginning on the first date that payment of such damages is required, and only if the bankruptcy court finds that nondischarge of the obligation would be unconscionable.

STATEMENT OF THE CASE

This proceeding emanates from a bankruptcy case filed under Chapter 7 of the Bankruptcy Code on October 18, 1990, at Bankruptcy No. 90-00765E in the United States Bankruptcy Court for the Western District of Pennsylvania. On November 2, 1990, your Petitioner filed a complaint to determine dischargeability of the obligation owed to the United States of America, National Health Service Corps (hereafter "Government" or "National Health Service Corps") and three other defendants, First Eastern Bank, Hahnemann University and Pennsylvania Higher Education Assistance Agency; the latter three entities are not involved in this appeal. This is a core proceeding in which the bankruptcy court had jurisdiction under 28 U.S.C. § 157 (b) (2) (I).

After a motion for reconsideration was denied, the Government on February 17, 1993, appealed to the United States District Court for the Western District of Pennsylvania, which had jurisdiction under 28 U.S.C. §158 (a). Upon affirmance by the district court, the Government appealed to the United States Court of Appeals for the Third Circuit, which had jurisdiction under 28 U.S.C. §158 (d).

At the initiation of her bankruptcy proceeding, your Petitioner was facing liability of approximately $400,000.00 —considerably more now -- as a result of educational loans given to her in the total amount of $46,726.00 under the National Health Service

Program, 42 U.S.C. §§ 254d et seq. Your Petitioner, Mary Susan Matthews, graduated from Hahnemann Medical College in Philadelphia, Pennsylvania, in June, 1982; and she underwent her residency at Wheeling Hospital in West Virginia. Her medical education had been partially funded by scholarship awards from the National Health Service Corps for three academic years to 1982; the total amount furnished by the National Health Service Corps was $46,726.00.

The debtor had initially applied for an award from the National Health Service Corps Scholarship Program in 1979 in accordance with the then-existing legislation, 42 U.S.C. §§ 254*d* et seq. The statutory provisions required your Petitioner to serve in a Health Manpower Shortage Area (usually hereafter "HMSA") for the period stated in her contract with the Corps: see 42 U.S.C. §254*m* (a). In her case your Petitioner would have been required to serve for three years, one year for each year of financial assistance.

At the time your Petitioner applied in 1979 and during her tenure at Hahnemann, the Government's practice was to allow award recipients to make the initial selection of the site to which they would be assigned, which selection would then be approved by the Corps. Thereafter, as a result of language emanating from the Senate Appropriations Committee, S. Rep. No. 427, 98th Cong., 1st Sess. (1983), the National Health Service Corps modified its procedure so as to allow it to make the initial selection of the area to which recipients would be allowed to practice. The change was precipitated by the 1981 amendment to 42 U.S.C. 254*n*(a) (2), which required scholarship recipients to practice in a Health Manpower Shortage Area selected by the Secretary. Before that time physicians had greater discretion to make their initial selections. An Application Information Bulletin for the 1979-80 school year stated, "The NHSC process is designed to allow Scholarship recipients the maximum choice feasible among

available sites." S. App. at 284. ("S. App." refers to the Supplemental Appendix filed with the court of appeals in this case.) After the amendment the Secretary of Health and Human Services developed the so-called "HMSA Placement Opportunity List," or "HPOL," from which the scholarship recipient was expected to select. The change rendered by the 1981 amendment to the statute is described in the *United States v. Duffey*, 879 F.2d 192, 196 (6th Cir. 1989). As your Petitioner stated in one of her affidavits submitted to the bankruptcy court, "[t]he flexibility which I initially encountered was substantially eliminated by NHSC's decision to restrict the areas of availability to those on the so-called 'HMSA Placement Opportunity List,' or 'HPOL.'" S. App. at 263. After the debtor graduated from Hahnemann and concluded her residency, your Petitioner set up practice in Saegertown and Conneautville in Crawford County, Pennsylvania. Her private office is at R.D. # 4, Erie Street Extension, Saegertown, Pennsylvania; and she divides her time with the Conneaut Valley Health Center located in Conneautville.

At all relevant times Crawford County was a designated HMSA. However, by letter dated September 5, 1984, the Department of Health and Human Services nevertheless denied the debtor's request for assignment to Crawford County because it did not have a priority for placement. By notice dated November 29, 1984, the Government assigned your Petitioner to the state of South Dakota in fulfillment of service obligation under the National Health Service Corps Scholarship Program.

By letter dated August 10, 1984, the Department of Health and Human Services advised the Pennsylvania Department of Health that it was designating Conneautville, Pennsylvania, as a Health Manpower Shortage Area: see the designation for same in the Federal Register for September, 1985, 50 Fed. Reg. 38,444, 38,481 (September 20, 1985), S. App. at 300. Thereafter by letter dated

October 19, 1985, the Conneaut Valley Health Center, where your Petitioner worked, requested ("implore" was the word used) that the Government allow her to fulfill part of her NHSC obligation at its facility in Conneautville. S. App. at 303. The Government did not accede to this request.

The debtor did not comply with the Government's directive to practice in the state of South Dakota and instead practiced in Saegertown and Conneautville, Pennsylvania. As a result of this violation of the Petitioner's contract, the Government filed suit against her in the United States District Court for the Western District of Pennsylvania at Civil Action No. 87-210 Erie; and by Order dated February 15, 1991, the District Court granted judgment against the Petitioner in the principal amount of $140,178.00 plus pre-judgment interest. Judgment in this large amount was rendered in accordance with 42 U.S.C. § 254*o* (b), which allows the Government to receive treble the amount of its scholarship awards plus interest thereon. With pre-judgment interest, the total amount of the award rendered in favor of the Government in the Civil Action was $255,572.19. The Government's answers to interrogatories in the bankruptcy proceeding indicated that the daily factor or interest was $77.64 as of December 20, 1990 and that the balance owed was $379,485.74 as of that date. S. App. at 19-20. Interest only on the principal indebtedness, therefore, was $28,338.60 per year. No appeal was taken from the district court's judgment in the civil action.

There was considerable factual development in discovery which preceded the parties' cross-motions for summary judgment. Income tax returns were produced, as were the Petitioner's schedules in the bankruptcy; and Dr. Matthews and her husband were extensively examined at a deposition on June 25, 1991. In an affidavit submitted in support of her motion for summary judgment, your Petitioner stated, "I have no reason to believe that my income,

net before taxes, would increase significantly beyond $85,000.00 per year, and there is nothing which I reasonably could do to change this situation." S. App. at 234. However, in prior years, Dr. Matthews made considerably less: $48,270.00 in 1986, $62,177.00 in 1987, $27,089.00 in 1988, $43,088.58 in 1989. S. App. at 208. The record submitted to the court of appeals was somewhat voluminous.

The record is replete with documentation as to your Petitioner's income, assets, and general financial situation. However, at no time before the Government and Petitioner filed cross-motions for summary judgment — for that matter, at no time before the bankruptcy court filed its opinion and order of December 30, 1992, resolving the motion for summary judgment — did the Government raise or otherwise present to the Court, by briefs or otherwise, the contention that the Government continued to offer Dr. Matthews the opportunity to earn a discharge of her indebtedness by now complying with a directive to move her practice to a current HPOL of the Government's selection. Accordingly the evidentiary record contains no references to this proposal; nor are there any facts presented in rebuttal to this argument, as it had never been raised. The Government first alluded to such a proposal by way of a motion for reconsideration, S. App. at 530, which motion the Bankruptcy Court refused.

On appeal the United States Court of Appeals for the Third Circuit reversed the bankruptcy court, as affirmed by the United States District Court, for two reasons. First, the court held, it would not be unconscionable for the Petitioner to be required to repay the entire amount of the judgment, as she had "the option of fulfilling her service obligation even at this late date." *Matthews v. Pineo*, No. 93-3401, slip op. at 6 (3d Cir. Mar. 15, 1994). Secondly, the court ruled that Dr. Matthews did not bear her burden of demonstrating that she could not earn more by changing her

practice, relocating to a higher paying area, reducing her expenditures, or showing that to undergo such changes would be shockingly unfair. Slip op. at 7.

REASONS FOR GRANTING THE WRIT

Departure from usual course of judicial proceedings. The court of appeals relied largely, perhaps primarily, upon the fact that the National Health Service Corps offered your Petitioner the opportunity of fulfilling her service obligation and negating the judgment by locating in a current health Manpower Shortage Area of the Government's selection. This was most definitely not among the issues raised before the bankruptcy court where the record was developed for purposes of the cross-motions for summary judgment. The Government first raised this offer as a defense in its motion for reconsideration of the bankruptcy court's order of December 30, 1992. S. App. at 526, 530. Previous pleadings, motions, and briefs are bereft of any suggestion of this proposal or argument based on same.

It is not difficult to understand the change in legal theory. The bankruptcy court's determination, as affirmed by the district court, is supported by an abundant record and clear precedent allowing the bankruptcy court to exercise its discretion to reduce an unconscionable repayment to a reasonable amount. Rather than face a loss, the Government offered to send Dr. Matthews for three years to a currently designated HPOL.

In the brief submitted to the court of appeals, your Petitioner argued that motions for reconsideration should not be used to raise points which could no longer be effectively rebutted, as the record had been closed. The following was quoted from *In re Oil Spill by the "Amoco Cadiz,"* 794 F. Supp. 261, 267 (N.D. Ill. 1992):

> Motions for reconsideration cannot be used to introduce new legal theories for the first time, to raise legal argumentation which could have been heard during the pendency of a previous motion, *Publisher's Resource [v. Walker-Davis Publications]*, 762 F.2d [557] at 561 [(7th Cir. 1985)]; *In re Sisson*, 668 F. Supp. 1196 (N.D. Ill. 1987), in order to present evidence that could have been adduced during the pendency of the original motion. *Keen Corp. [v. Int'l. Fidelity Ins. Co.]*, 561 F. Supp. [656] at 665 [(N.D. Ill. 1983)].

Nor should a disappointed appellant be permitted to argue to the court of appeals that which should not have been subject to reconsideration in the district court or bankruptcy court: see *Seamon v. Vaughan*, 921 F.2d 1217, 1220 (llth Cir. 1991) (court refused to review arguments on amount owed and attorney's fees raised only in motion for reconsideration "because Administrators fail to present it to the district court until after final judgment.")

This should be especially the case when the successful party in the motion for summary judgment (if paying one-half of this substantial obligation can be viewed as successful) was effectively precluded from addressing an issue which was not then relevant. "[T]he ground must have been adequately presented in the trial court so that the non-moving party had an opportunity to submit affidavits or other evidence and contest the issue." *Box v. A & P Tea Company*, 772 F.2d 1372, 1376 (7th Cir. 1985).

Along the same lines, the ready acceptance by the court of appeals as to the Government's "general policy of extending this opinion to scholarship recipients such as Dr. Matthews," slip op. at 6n. 3, is not supportable from the record. Before oral argument to the court of appeals, your Petitioner had never been advised of such a "general policy," the criteria for same, or the availability of some documentation that would show its applicability. Its

existence would appear to be inconsistent with the Special Repayment Program, Pub. L. No. 177, § 204, 101 Stat. 987, 1000-03 (1987), which offered defaulting recipients an opportunity to pay off their loans by service but which had various written criteria and in any case expired on May 29, 1988. See the implementing regulations, 42 C.F.R. §§ 62.71 et seq. (1993), and the discussion in *United States v. Gary,* 963 F.2d 180, 182-83 (8th Cir. 1992). What similar authority supports this "general policy"? Further, the opinion and order in the United States District Court in the civil action, *United States v. Matthews,* Civil Action No. 87-210 Erie, nowhere suggests that the judgment was subject to the Petitioner's ability to satisfy same by service in a HPOL that would be later designated; the Government simply sued for a monetary judgment and got it.

The Government's post-judgment proposal was, therefore, either an offer of settlement or, as the Government appears to prefer, the raising of a new substantive issue as a defense after judgment had been entered. Under the first rationale, consideration of this offer contradicts Rule 408 of the Federal Rules of Evidence; under the second, its use after the record was closed prevented the Petitioner from producing any evidence that acceptance of the offer would have been extremely difficult, harsh, and unwise — that is, unconscionable.

Important question of law to be settled by this court. The opinion of the court of appeals in this case represents the first decision by a court of appeals on the standard of unconscionability under 42 U.S.C. § 254*o* (d) (3) (A). There are other cases originating in various parts of the country, but to date only this case has resulted in a decision from an appellate court.

The opinion from the court of appeals might lead this Court to believe that there had been a dispute as to the ability of the

Petitioner to increase her net income available for payment by increasing her gross revenues, moving to a higher-paying area, or reducing her expenses. This was never at issue. In Dr. Matthews' affidavit submitted in support of her motion for summary judgment, she stated, "I have no reason to believe that my income, net before taxes, would increase significantly beyond $85,000.00 per year, and there is nothing which I reasonably could do to change the situation." S. App. at 234. Under Rule 56(e), F.R. Civ. P. applicable to this case under Rule 7056, F.R. Bankr. P., an opposing party contesting this allegation is supposed to file a counter-affidavit and cannot rely upon the pleadings. No counter-affidavit was ever filed; and the Government's answer, S. App. at 007-010, never mentions the issue. The court of appeals, like the lower courts before, was also presented with exhaustive documentation as to the Petitioner's financial situation. This included the Petitioner's schedules in the bankruptcy proceeding, S. App. at 550; the Petitioner's answers to interrogatories, which indicated that she made much less than $85,000.00 in prior years ($27,089.00 in 1988 and $43,088.58 in 1989, for example), S. App. at 208; and extensive questioning of Dr. Matthews at a deposition with regard to her debts and expenses, S. App. at 159 et seq.

The appellate court's reasoning on page 7 of its opinion is therefore hasty in the extreme. The court wants scholarship recipients such as Dr. Matthews "who flout their scholarship commitments to live like average taxpayers"; but there is no discussion that this would be possible after payments to the government even at Petitioner's (moderate, it is submitted) projected level of income, much less the considerably reduced income which she made during the years preceding the filing of her bankruptcy petition. The court's rationale betrays none of the extensive and penetrating analysis which the bankruptcy court demonstrated in *In re Gray,* Case No. 88-12452-CJK, Adv. Proc.

No. 89-1102-CJK (Bankr. D. Mass. Mar. 20, 1990), reproduced in the appendix hereto. In *Gray* the debtor, who had a medical degree but could not pass his medical boards, earned a gross salary of $90,000.00 per year but faced an obligation to the National Health Service Corps in an amount exceeding $550,000.00 (as trebled). Interest alone exceeded $30,000.00 per year, a figure comparable to that faced by your Petitioner in this case. Like Judge Bentz in the instant case, the court reasoned that the appropriate course of action would be to reduce the nondischargeable portion of the obligation to $193,772.32 — proportionately more than the reduction afforded to Dr. Matthews.

The heavy-handed approach of the court of appeals further precludes development of criteria along the lines used by the lower courts in examining the "undue hardship" that must be found before the usual kind of student loan is discharged under Section 523 (a) (8) of the Bankruptcy Code, 11 U.S.C. § 523 (a) (8). The bankruptcy courts across the country have been using a combination of three tests to determine undue hardship, namely, the "mechanical test" which compares a debtor's present and future income and expenses to the loan to be repaid, the "good faith" test which focuses upon the debtor's prospects for increasing income or reducing expenditures in a manner that would allow the student loan to be repaid, and the "policy" test which looks to the dominant purpose of the bankruptcy filing and the extent to which the debtor has benefited from the education financed by the loans. All three tests were identified and employed in *In re Bakkum*, 139 B.R. 680 (Bankr. N.D. Ohio 1992), where the court reduced the nondischargeable portion of educational loans from $76,000.00 to $36,679.29. See also *Vaughn v. Illinois State Scholarship Comm.*, 151 B.R. 481 (C.D. Ill. 1993). The balancing of factors was similarly used by the court in *In re Gray*. Clearly, the bankruptcy court in the instant case also engaged in a balancing of factors to

work out a formula by which the Government might actually be paid. "Payment of 50% of the obligation is not an insubstantial amount and *will present a hardship* to the Debtor — but not a harsh or unjust requirement — while providing the means and method of substantial repayment to the NHSC." P. 30a, *infra* (emphasis added). The opinion of the court of appeals indicates that none of this was perceived for purposes of analysis, and this Court's review is important to the petitioner and others similarly situated so that the correct criteria can be uniformly applied.

Additional federal question of importance. As can be seen from the bankruptcy court's memorandum refusing the Government's motion for reconsideration, Judge Bentz determined that your Petitioner's significant service in a Health Manpower Shortage Area, different from that designated by the Government, was a relevant factor in determining the dischargeability of any portion of the obligation. "We believe that Debtor's service may be considered as a factor in the application of the 'unconscionable' standard." P. 29a, *infra*. In its motion for reconsideration, the Government had objected to the bankruptcy court's consideration of this evidence. S. App. at 528. However, as the bankruptcy court pointed out, although a defaulting physician's service in an HMSA different from that designated by the Government would be no defense for a claim for damages for breach under 42 U.S.C. § 254*o* (b), as demonstrated by the judgment in the civil action against your petitioner, it does have relevance in analyzing the equitable considerations in determining unconscionability:

> The NHSC is correct that the Debtor's practice in Saegertown and Conneautville has no bearing on the damages she owes to the NHSC. The determination of the liability, however, is different from the determination of dischargeability in bankruptcy.

P. 29a, *infra*. Cases where the Government successfully sued for

damages outside bankruptcy are therefore not controlling. Judge Bentz is not the first bankruptcy judge to consider such service as a mitigating factor. In *In re Luna*, 54 B.R. 637 (Bankr. S.D. Fla. 1984), a case applying Section 523 (a) (8) of the Bankruptcy Code, the court expressly credited the debtor for service in a rural area despite the fact that it had not been designated by the Public Health Service.

There is no question that your Petitioner provided significant, probably critical medical services for a designated HMSA. The Conneaut Valley Health Center, where she spends a good deal of her time, has been serviced by other physicians placed by the National Health Service Corps, S. APP. at 306; and Dr. Matthews' obstetrical services were needed. By letter dated October 19, 1985, S. App. at 303, the chief operating officer of the Conneaut Valley Health Center wrote the Government, noted that the Center was (and is) a NHSC-approved and designated Rural Health Center, and literally begged the Government ("I implore you to seriously consider...") to allow Dr. Matthews to continue her service there. "Because of Dr. Matthews's preparation as a specialist in Family Practice she is able to provide these much needed services [in obstetrical and limited pediatric care] for the patients who come to us seeking care."

The bankruptcy court therefore had ample evidence to weigh this significant and beneficial service as an ameliorating factor. Such service, while no defense for a claim for civil damages, is consistent with the purpose of the National Health Service Corps, which is to "eliminat[e] health manpower shortages in health professional shortage areas...." 42 U.S.C. § 254d (a) (1). The apparent requirement that your Petitioner move to a higher-paying area, as enunciated by the court of appeals, undercuts this purpose.

None of this is meant to imply that your Petitioner, who is

maintaining no more than a middle-class standard of living, is pleased with the prospect of having to come up with an amount now considerably in excess of $200,000.00. This presents a significant hardship, as the bankruptcy court indeed intended. With considerable effort, however, repayment might be possible.

Your Petitioner asks that this Court review these important issues of federal law.

CONCLUSION

For these reasons a Writ of Certiorari should issue to review the judgment and opinion of the United States Court of Appeals for the Third Circuit.

Respectfully submitted,

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APPENDIX

Filed March 15, 1994

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 93-3401

MARY SUSAN MATTHEWS

v.

WILLIAM PINEO, ESQ.; UNITED STATES OF AMERICA; NATIONAL HEALTH SERVICE CORPS; FIRST EASTERN BANK; HAHNEMANN UNIVERSITY; PENNSYLVANIA HIGHER EDUCATION ASSISTANCE AGENCY

United States of America and the
National Health Service Corps,
Appellants

ON APPEAL FROM THE UNITED STATES
DISTRICT COURT FOR THE
WESTERN DISTRICT OF PENNSYLVANIA
(D.C. Civil No. 93-00038)

Argued: January 13, 1994

Before: STAPLETON, COWEN, and ALITO,
Circuit Judges

(Opinion Filed: March 15, 1994)

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OPINION OF THE COURT

ALITO, *Circuit Judge*:

The United States of America and the National Health Service Corps ("NHSC") have appealed from a district court order that affirmed a bankruptcy court order partially discharging the amount that Dr. M. Susan Matthews owes to the NHSC for breaching her agreement to provide service in the NHSC in exchange for a scholarship to attend medical school. Under 42 U.S.C. § 254o(d)(3)(A), such an obligation is dischargeable in bankruptcy only if nondischarge would be "unconscionable." The bankruptcy and district courts concluded that it would be "unconscionable" not to discharge one-half of Dr. Matthews' current obligation, but we hold that the standard of unconscionability was not met. We therefore reverse.

I.

The National Health Service Corps Scholarship Program, *see* 42 U.S.C. §§ 254d-254t, was enacted in 1976 to remedy the problem of maldistribution of health care professionals in the United States. See H.R. Rep. No. 266, 94th Cong., 2d Sess., pt. 1, 22 (1976), *reprinted in* 1976 U.S.C.C.A.N. 4947, 4964. Under this program, students of medicine and related professions are granted scholarships but must enter

into written agreements to provide one year of "obligated service" for each year of educational support (with a minimum service obligation of two years). 42 U.S.C. §§ 254*l*(f)-(g). This service must be performed "in a health professional shortage area (designated under [42 U.S.C. § 254e]) *to which [the scholar] is assigned by the Secretary* [of Health and Human Services]." 42 U.S.C. § 254*l*(f)(1)(B)(iv) (emphasis added). Each scholarship recipient must also agree in writing that, if he or she breaches this commitment, he or she will be liable for liquidated damages of three times the amount of scholarship support received, as well as interest.[1] 42 U.S.C. § 254*o*(b)(1)(A).

Congress has severely limited the conditions under which an NHSC scholarship obligation may be discharged in bankruptcy. Pursuant to a 1987 amendment, such an obligation may be discharged only after the passage of five years and "only if the bankruptcy court finds that nondischarge of the obligation would be unconscionable." 42 U.S.C. 254*o*(d)(3)(A).

Dr. Matthews received NHSC scholarships, totaling $46,726.00, to attend Hahnemann Medical College in 1979, 1980, and 1981. In return, she signed an agreement to practice for three years in a suitable location selected by the Secretary of HHS. Dr. Matthews also agreed that if she violated this agreement she would be liable for the liquidated damages specified by statute.

After graduation from medical school, Dr. Matthews was given a three-year deferment of her service obligation so that she could complete a family practice residency. In July 1984, she was given the opportunity to arrange for the performance of her service obligation at any site designated on the NHSC's Health Manpower Shortage Area Placement Opportunity List as having a vacancy for a physician with her specialty. The Conneaut Valley Health Center in Crawford County, Pennsylvania, was designated on this list as needing an internist, not a physician specializing in family practice. Nevertheless, Dr. Matthews requested placement at the Conneaut Valley Health Center. The NHSC

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1. If the scholarship recipient partially fulfills his or her obligation, the amount of damages is reduced. See 42 U.S.C. § 254*o*(b)(1)(A).

did not grant this request, but instead assigned her to South Dakota.

Dr. Matthews made no effort to locate a placement in South Dakota. Instead, she established a practice in the location of her choice, Crawford County, Pennsylvania. She currently divides her time between a private family practice in Saegertown and work at the Conneaut Valley Health Center.

As a result of Dr. Matthews' refusal to fulfill her service obligation, the NHSC brought suit against her in the United States District Court for the Western District of Pennsylvania to recover the damages provided by statute. In February 1990, the district court granted summary judgment for the NHSC in the amount of $140,178 plus prejudgment interest.

Instead of paying this judgment, Dr. Matthews filed for bankruptcy under Chapter 7 of the Bankruptcy Code and commenced an adversary proceeding to obtain discharge of various student loan obligations, including the obligation stemming from her NHSC scholarship. After both sides in this adversary proceeding moved for summary judgment, the bankruptcy court held that one-half of Dr. Matthews' NHSC obligation, which by then had risen to nearly $400,000, was dischargeable. The court wrote:

> Considering all of the facts and circumstances of this case, we find the matter unconscionable in two respects — first, it is shockingly unfair for the Debtor to receive all the benefits from the NHSC and then refuse to perform her service obligation. Second, it is outside the limits of what is reasonable to hold the Debtor in a virtual receivership by requiring the repayment of nearly $400,000, which even with the Debtor's income is a near impossibility. The fresh start provisions of the Bankruptcy Code do not contemplate perpetual indebtedness beyond a reasonable repayment period.

Matthews v. United States (In re Matthews), 150 B.R. 11, 14 (Bankr. W.D. Pa. 1992), *aff'd* No. 93-00038E (W.D. Pa. June 14, 1993).

The NHSC moved for reconsideration and argued that Dr. Matthews could still avoid having to pay liquidated damages if she would simply fulfill her service obligation. The bankruptcy court denied this motion, observing that "to require the Debtor to now close her practice, leave her home and the building in which she practices, possibly separate herself from her husband, and uproot her children's lives for temporary relocation to a NHSC high priority area is outside the limits of what is reasonable." *Matthews v. United States (In re Matthews)*, Ch. 7 Case No. 90-00765E, Adv. No. 90-0133, op. at 2-3 (Bankr. W.D. Pa. Jan. 19, 1993).

The NHSC appealed to the district court, but that court affirmed the bankruptcy court's order without opinion. This appeal followed.

II.

Under Section 254o(d)(3)(A), an obligation stemming from a NHSC scholarship is dischargeable in bankruptcy only "if the bankruptcy court finds that nondischarge of the obligation would be unconscionable."[2] In ordinary usage, the term "unconscionable" means "excessive, exorbitant," "lying outside the limits of what is reasonable or acceptable," "shockingly unfair, harsh, or unjust," or "outrageous." Webster's Third New International Dictionary 2486 (1977). In the absence of contrary indications, we presume that Congress, in employing the term "unconscionable" in Section 254o(d)(3)(A), meant to adopt this definition. *Smith v. United States*, 113 S. Ct. 2050, 2054 (1993); *Perrin v. United States*, 444 U.S. 37, 42 (1979). We note that other bankruptcy courts — and, indeed, the bankruptcy court in this case — have adopted essentially the same definition. *See, e.g., In re Green*, 82

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2. The meaning of the term "unconscionable" is a question of law over which we exercise plenary review. The parties disagree as to whether the bankruptcy court's application of this concept to the facts of this case should be reviewed under the plenary or abuse of discretion standard. We need not decide this question, however, since the bankruptcy court's decision cannot be sustained under either standard.

B.R. 955, 959 (Bankr. N.D. Ill. 1988); *In re Quinn*, 102 B.R. 865, 867 (Bankr. M.D. Fla. 1989).

Applying this definition, we hold that nondischarge of Dr. Matthews's entire debt would not be "unconscionable." First, we find it significant that the NHSC has presented Dr. Matthews with the option of fulfilling her service obligation even at this late date.[3] As noted, the bankruptcy court felt that it would be "outside the limits of what is reasonable" to require Dr. Matthews to "close her practice, leave her home and the building in which she practices, possibly separate herself from her husband, and uproot her children's lives for temporary relocation to a NHSC high priority area." *Matthews*, Ch. 7 Case No. 90-00765E, Adv. No. 90-0133, op. at 2-3. This reasoning, however, appears to misapprehend the extremely limited scope of the concept of unconscionability. An option is not "unconscionable" simply because it may be disruptive, unpleasant, undesirable, or painful. Instead, to be "unconscionable" an option must be "shockingly unfair, harsh, or unjust" or "outrageous," and the facts cited by the bankruptcy court and by Dr. Matthews do not show that a temporary relocation to satisfy her service obligation would rise to this level. These facts show little more than that Dr. Matthews and her family would experience some of the ordinary difficulties of relocation, and we do not believe that the ordinary difficulties of relocation can be regarded as "unconscionable." Each year many Americans must uproot their families and move because they are transferred by their employers or because they cannot find satisfactory work where they currently live.

Second, even if Dr. Matthews did not have the option of avoiding the payment of liquidated damages by fulfilling her service commitment, she failed to demonstrate that nondischarge of the full amount she owes would be "unconscionable." The bankruptcy court reasoned, based on Dr. Matthews' current income of $85,000 per year, that it would be nearly impossible for Dr. Matthews to pay off her NHSC obligation. Elaborating on this reasoning, Dr.

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3. The NHSC states that it has a general policy of extending this option to scholarship recipients such as Dr. Matthews.

Matthews claims that the annual payments needed to pay off her NHSC obligation and the accumulating interest on this obligation would exceed the difference between her current annual income and her current annual expenses. This argument is flawed, however, because it assumes that, in determining whether nondischarge would be "unconscionable," both Dr. Matthews' current income and her current expenses should be regarded as unalterable. Instead, the proper inquiry is whether it would be "unconscionable" to require Dr. Matthews to take any available steps to earn more income or to reduce her expenses.

Dr. Matthews bore the burden of proving unconscionability, and she failed to discharge that burden. She did not point to facts in the summary judgment record establishing that she could not earn more by changing her practice or relocating to a higher paying area, or that requiring her to undergo such changes would be "shockingly unfair, harsh, or unjust." Similarly, she did not point to facts in the summary judgment record showing that it would be "outrageous" to require her to reduce her expenses. The test for unconscionability is not whether repayment of an NHSC obligation would prevent the debtor from maintaining the standard of living of the average physician or the standard of living to which the debtor is accustomed. Average taxpayers subsidize the medical education of NHSC scholarship recipients. Requiring such recipients who flout their service commitments to live like average taxpayers is not "unconscionable."

III.

In sum, we hold that the nondischarge of Dr. Matthews' entire NHSC obligation is not "unconscionable." We will therefore reverse the order of the district court and remand for the entry of an order holding that Dr. Matthews' entire NHSC obligation is nondischargeable.

A True Copy:
Teste:

Clerk of the United States Court of Appeals
for the Third Circuit

UNITED STATES COURT OF APPEALS
FOR THE THIRD CIRCUIT

No. 93-3401

MARY SUSAN MATTHEWS

v.

WILLIAM PINEO, ESQ.;
UNITED STATES OF AMERICA;
NATIONAL HEALTH SERVICE CORPS;
FIRST EASTERN BANK; HAHNEMANN UNIVERSITY;
PENNSYLVANIA HIGHER EDUCATION ASSISTANCE AGENCY

United States of America and the
National Health Service Corps,
Appellants

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF PENNSYLVANIA
(D.C. Civil No. 93-00038)

Present: Stapleton, Cowen and Alito, Circuit Judges

JUDGMENT

This cause came to be heard on the record from the United States District Court for the Western District of Pennsylvania and was argued by counsel on January 31, 1994.

On consideration whereof, it is now here ordered and adjudged by this Court that the order of the said District Court entered June 14, 1993, be, and the same is hereby reversed and the cause is remanded to the District Court for the entry of an order holding that Dr. Matthews' entire NHSC obligation is non-dischargeable.

Costs taxed against the appellee. All of the above in accordance with the opinion of this Court.

ATTEST:

P. Douglas Sisk
Clerk

Dated: March 15, 1994

IN THE UNITED STATES DISTRICT COURT
FOR THE WESTERN DISTRICT OF PENNSYLVANIA

IN RE

M. SUSAN MATTHEWS, Debtor

M. SUSAN MATTHEWS,

Plaintiff

v.

UNITED STATES OF AMERICA, NATIONAL HEALTH SERVICE CORPS, FIRST EASTERN BANK, HAHNEMANN UNIVERSITY, PENNSYLVANIA HIGHER EDUCATION ASSISTANCE AGENCY, and WILLIAM PINEO,

Trustee,

Defendants

Civil Action No. 93-38 Erie
Bankruptcy No. 90-765 Erie
Adversary No. 90-133

ORDER

AND NOW, this 11th day of June, 1993, after consideration and for the reasons set forth in the learned opinion of the Honorable Warren W. Bentz, United States Bankruptcy Judge, which we hereby adopt in support of this Order,

IT IS HEREBY ORDERED that:

(1) The defendants' appeal of the December 30, 1992 Order of Judge Warren W. Bentz, United States Bankruptcy Judge, which

discharged one-half of the obligation of M. Susan Matthews to the United States of America, National Health Service Corps is DENIED.

(2) The said December 30, 1992 Order of Judge Warren W. Bentz, United States Bankruptcy Judge, is AFFIRMED.

United States District Judge

cm: All parties of record

UNITED STATES BANKRUPTCY COURT
FOR THE WESTERN DISTRICT OF PENNSYLVANIA

IN RE M. SUSAN MATTHEWS, DEBTOR	BANKRUPTCY NO. 90-00765E
M. SUSAN MATTHEWS, Plaintiff V. UNITED STATES OF AMERICA, NATIONAL HEALTH SERVICE CORPS: FIRST EASTERN BANK; HAHNEMANN: UNIVERSITY; PENNSYLVANIA HIGHER EDUCATION ASSISTANCE AGENCY; AND WILLIAM PINEO, TRUSTEE, Defendants	ADVERSARY NO. 90-0133

MEMORANDUM

Presently before the Court is a Motion for Reconsideration of Opinion and Order [of] December 30, 1992 ("Motion") filed by the United States of America, National Health Service Corps ("NHSC").

The NHSC asserts that we erroneously included as relevant factors in the application of the "unconscionable" standard that (1) "the Debtor did make an effort to gain permission to perform her service requirements in a different medically underserved area, albeit not one of the most needy areas designated by the NHSC"; and (2) "[t]he Debtor has provided some medical service in a medically underserved area."

The NHSC is correct that the Debtor's practice in Saegertown and Conneautville has no bearing on the damages she owes to the NHSC. The determination of the liability, however, is different from the determination of dischargeability in bankruptcy. We believe that the Debtor's service may be considered as a factor in the application of the "unconscionable" standard.

The NHSC cites us to several cases in support of its proposition that repayment in full is reasonable. United States v. Haithco, 644 F.Supp. 63 (WD Mich. 1966); United States v. Padavano, 644 F.Supp. 28 (D. Me. 1987); United States v. Redovan, 656 F.Supp. 121 (ED Pa. 1986). None of those cases involve a determination of dischargeability in bankruptcy.

The NHSC cites us to In re Dillingham, 104 BR 505 (Bankr. ND Ga. 1989) for the proposition that the Debtor has failed to prove that survival of the obligation to NHSC would be unconscionable. Compared to this case, Dillingham involved a modest amount, $100,000 as opposed to $400,000 in the within matter. Prior to rendering our Opinion, we considered monthly payments which would be required to satisfy the obligation in ten, fifteen or twenty years. We found and continue to find that repayment of the entire obligation would require shockingly unfair payments beyond the Debtor's present or anticipated capability. Payment of 50% of the obligation is not an insubstantial amount and will present a hardship to the Debtor— but not a harsh or unjust requirement—while providing the means and method of substantial repayment to the NHSC.

Further, to require the Debtor to now close her practice, leave her home and the building in which she practices, possibly separate herself from her husband, and uproot her children's lives for temporary relocation to a NHSC high priority area is outside the limits of what is reasonable.

The NHSC's Motion will be refused. An appropriate Order will be entered.

Dated: January 19 , 1993

Warren W. Bentz

Warren W. Bentz
United States Bankruptcy Judge

c: Gary V. Skiba, Esq.
Mary McKeen Houghton, Esq.
U.S. Trustee

UNITED STATES BANKRUPTCY COURT
FOR THE WESTERN DISTRICT OF PENNSYLVANIA

IN RE M. SUSAN MATTHEWS, DEBTOR	BANKRUPTCY NO. 90-00765E
M. SUSAN MATTHEWS, Plaintiff: V. UNITED STATES OF AMERICA, NATIONAL HEALTH SERVICE CORPS: FIRST EASTERN BANK; HAHNEMANN: UNIVERSITY; PENNSYLVANIA HIGHER EDUCATION ASSISTANCE: AGENCY; AND WILLIAM PINEO, : TRUSTEE, Defendants	ADVERSARY NO. 90-0133

ORDER

This 19 day of January, 1993, in accordance with the accompanying Memorandum, it shall be, and hereby is, ORDERED that the Motion for Reconsideration of Opinion and Order [of] December 30, 1992, filed by the United States of America, National Health Service Corps, is REFUSED.

Warren W. Bentz

Warren W. Bentz
United States Bankruptcy Judge

c: Mary McKeen Houghton, Esq.
Gary V. Skiba, Esq.
U.S. Trustee

UNITED STATES BANKRUPTCY COURT
FOR THE WESTERN DISTRICT OF PENNSYLVANIA

IN RE M. SUSAN MATTHEWS, DEBTOR	BANKRUPTCY NO. 90-00765E
M. SUSAN MATTHEWS, Plaintiff: V. UNITED STATES OF AMERICA, NATIONAL HEALTH SERVICE CORPS: FIRST EASTERN BANK; HAHNEMANN: UNIVERSITY; PENNSYLVANIA HIGHER EDUCATION ASSISTANCE: AGENCY; AND WILLIAM PINEO, : TRUSTEE, Defendants	ADVERSARY NO. 90-0133

APPEARANCES

MARY MCKEEN HOUGHTON, ESQ., PITTSBURGH, PA, Attorney for United States of America, National Health Service Corps.

GARY V. SKIBA, ESQ., ERIE, PA, Attorney for M. Susan Matthews

U.S. TRUSTEE, PITTSBURGH, PA

BENTZ, Warren W., Bankruptcy Judge

DECEMBER 30, 1992

OPINION

Introduction

M. Susan Matthews ("Debtor") filed a voluntary petition under Chapter 7 of the Bankruptcy Code on October 18, 1990. TheDebtor initiated the within Adversary Proceeding to determine the

dischargeability of various student loan obligations. Presently before the Court are cross-motions for Summary Judgment by the Debtor and the United States of America, National Health Service Corps ("NHSC"). The Debtor's Complaint is a core proceeding under 28 U.S.C. §157 (b) (2) (I) over which we have jurisdiction.

Upon review of the record, including the Complaint, Answer, the NHSC's Motion and Amended Motion for Summary Judgment, the Debtor's Motion for Summary Judgment, Briefs, Reply Briefs, Supplemental Briefs, answers to interrogatories, and Affidavits, we find that there are no material issues of fact and that this matter is ripe for decision.

Factual Background

The Debtor is a physician engaged in family practice in Saegertown and Conneautville, Pennsylvania. She graduated from Hahnemann Medical College ("Hahnemann") in June, 1982. Her medical education was partially funded by scholarship awards NHSC for three academic years, 1979-82, in the aggregate amount of $46,726. In return for the scholarship awards, the Debtor agreed to serve in a health manpower shortage area assigned by the NHSC for three years, one year for each year of financial assistance.

Following a deferment of three years after the Debtor's graduation from Hahnemann to allow the Debtor to complete her residency requirements, the NHSC assigned the Debtor to the State of South Dakota to complete her service requirements.

The Debtor failed to comply with the NHSC's assignment and chose instead to practice in Saegertown and Conneautville, Pennsylvania. As a result of the Debtor's breach of contract, the NHSC filed suit against the Debtor in the United States District Court for the Western District of Pennsylvania in Erie at Civil

Action No. 87-210. By Order dated February 15, 1990, the District Court entered judgment in favor of NHSC in the principal amount of $140,178 plus prejudgment interest. Judgment was rendered in accordance with 42 U.S.C. §254o (b), which allows the NHSC to receive treble the amount of its scholarship awards plus interest. The amount owed by the Debtor as of December 20, 1990 was $379,485.74.

The Debtor seeks to discharge this obligation. Under the NHSC program, dischargeability in bankruptcy is governed by 42 U.S.C. §254o (d) (3), which allows a discharge in bankruptcy if (1) five years has passed since the first date that payment of damages for breach of the scholarship contract is required, and (2) the bankruptcy court finds that nondischarge of the obligation would be unconscionable.

The provision of 42 U.S.C. §254o (d) (3) requiring a finding of unconscionability was added by Amendment in 1987, Pub.L.No. 100-177, 101 Stat. 992. Prior to the Amendment, the only condition for discharge was the expiration of five years from the time that payment was first required.

The Debtor asserts that excepting this obligation from discharge would be unconscionable because there is no reasonable possibility that the Debtor could over repay the amount owed and that the Debtor would be in virtual receivership with the NHSC with no possibility of recovery. In the alternative, the Debtor asserts that discharge should be granted because more than five years have expired from the time that the obligation to repay arose and the requirement that nondischarge of the obligation be unconsionable as set forth in 42 U.S.C. §254o (d) (3) is invalid as an inappropriate and unconstitutional retroactive application of this statutory provision. As a second alternative, the Debtor asserts that the obligation should be nondischargeable only to the extent of the

amount of the scholarship award, $46,726 plus interest on that amount.

NHSC asserts that the obligation is nondischargeable because less than five years have elapsed since the payment of the debt was first required. NHSC denies that it would be unconscionable to allow this obligation to survive bankruptcy.

Discussion

We can readily dispose of the Debtor's assertion of unconstitutional retroactive application of the 1987 Amendment to 42 U.S.C. §254o (d) (3) which added the requirement of unconscionability. Section 308 (b) of Pub.L. 100-177 provides that the Amendment applies only to bankruptcy proceedings in which discharge of an obligation to NHSC had not been granted within 30 days after its enactment.

The Debtor had no bankruptcy proceeding pending in 1987; the Amendment applies solely to future bankruptcy proceedings. It is not an unconstitutional retrospective application to apply the statute as it appeared in 1987 to the Debtor's 1990 bankruptcy filing.

Likewise, we can readily dispose of NHSC's assertion that five years have not elapsed since the first date that the Debtor's payment of damages was required. By letter dated June 6, 1985, NHSC declared the Debtor in default of her contract as of July 1, 1985 and advised her of the responsibility to pay the amount due. Thus, the first date that payment was required as per the NHSC's June 6, 1985 letter was July 1, 1985. The Debtor's bankruptcy proceeding was filed October 18, 1990, a date in excess of five years from the first date that the Debtor's payment for damages was required.

This brings us to the more difficult question of unconscionability. This is not the ordinary student loan case requiring the Court to find an "undue hardship" under 11 U.S.C. §523 (a) (8) (B). Discharge of an obligation to the NHSC is governed by 42 U.S.C. §254o (d) (3). §254o (d) (3) requires that we find it unconscionable to except this debt from discharge. Unconscionable is defined as outside the limits of what is reasonable or acceptable; an act which is shockingly unfair, harsh, or unjust.

We find elements on both sides of this case unconscionable. The Debtor used NHSC's scholarship money to obtain a medical degree and then failed to perform the service required by her contract. She chose instead to refuse to perform the required service in South Dakota and set up practice in another area. The purpose of NHSC's program is not just to provide education, but also to redistribute physicians to the most needy areas. Those who fail to abide by their contract incur substantial financial cost. The contract provides that a physician who fails to perform the required service must pay back three times the amount of educational funds provided by the NHSC, plus interest.

Were this Debtor seeking to discharge only the principal and interest on the amount received for her education, we would have little difficulty in denying discharge. The Debtor is a medical doctor who is board certified in family practice. She has a successful family practice and earns approximately $85,000 per year.

The Debtor, her husband and their two children are all in good health. She and her husband own their home, which is in good repair and valued at approximately $85,000. The Debtor's husband and a former business associate own the building valued at $150,000 in which she practices. She and another doctor pay her husband rent. Her husband and her former business associate will

own the building free and clear of liens in November, 1998.

In the instant situation, however, the amount which the Debtor seeks to discharge is not the amount she borrowed, but three times the amount.

Although not willing to relocate to South Dakota as required by the NHSC, the Debtor did make an effort to gain permission to perform her service requirements in a different medically underserved area, albeit not one of the most needy areas as designated by the NHSC. The Debtor has provided some medical service in a medically underserved area. Considering all of the facts and circumstances of this case, we find the matter unconscionable in two respects — first, it is shockingly unfair for the Debtor to receive all the benefits from the NHSC and then refuse to perform her service obligation. Second, it is outside the limits of what is reasonable to hold the Debtor in a virtual receivership by requiring the repayment of nearly $400,000, which even with the Debtor's income is a near impossibility. The fresh start provisions of the Bankruptcy Code do not contemplate perpetual indebtedness beyond a reasonable repayment period.

Accordingly, we will permit the Debtor to discharge one-half of her obligation to NHSC provided that the Debtor, within 60 days, proposes a suitable repayment schedule for the remaining balance of $189,742.87 (as of December 20, 1990) plus continuing interest.

Warren W. Bentz

Warren W. Bentz
United States Bankruptcy Judge

UNITED STATES BANKRUPTCY COURT
FOR THE WESTERN DISTRICT OF PENNSYLVANIA

IN RE M. SUSAN MATTHEWS, DEBTOR	BANKRUPTCY NO. 90-00765E
M. SUSAN MATTHEWS, Plaintiff: V. UNITED STATES OF AMERICA, NATIONAL HEALTH SERVICE CORPS: FIRST EASTERN BANK; HAHNEMANN: UNIVERSITY; PENNSYLVANIA HIGHER EDUCATION ASSISTANCE: AGENCY; AND WILLIAM PINEO, : TRUSTEE, Defendants	ADVERSARY NO. 90-0133

ORDER

This 30th day of December, 1992, in accordance with the accompanying Opinion, it shall be, and hereby is, ORDERED as follows:

1. Provided that M. Susan Matthews makes satisfactory payment arrangements for one-half of her obligation to the United States of America, National Health Service Corps within 60 days, the remaining one-half of the obligation will be discharged. 2. If M. Susan Matthews fails to make satisfactory payment arrangements for one-half of her obligation to the United States of America, National Health Service Corps within 60 days, the entire obligation will be nondischargeable.

Warren W. Bentz
Warren W. Bentz
United States Bankruptcy Judge

c: Mary McKeen Houghton, Esq.
Gary V. Skiba, Esq.
U.S. Trustee

United States Bankruptcy Court
District of Massachusetts

In re: William E. Gray, Jr., Debtor	Chapter 7 Case No. 88-12452-CJK
United States of America Plaintiff v. William E. Gray, Jr., Defendant	Adversary Proceeding No. 89-1102-CJK

Memorandum of Decision and Order
on Motions for Summary Judgment

The United States seeks a determination that a judgment obtained by the United States against the Debtor, which judgment arose from a National Health Service Corps (NHSC) scholarship agreement, is not dischargeable. The Debtor has filed a counter-claim seeking a determination that the judgment debt is dischargeable. Before the Court now are three motions for summary judgment, two by the Debtor and one by the United States.

The facts that gave rise to this proceeding are not in dispute. While the defendant was a medical student, he applied for and received $85,793.12 in scholarship awards from the NHSC Scholarship Program. In exchange for these funds, the defendant agreed that upon completion of his professional training, he would practice medicine for a certain time as a member of the NHSC in a designated Health Manpower Shortage Area. Under his scholarship agreement, if the defendant failed to complete his service obligation, he would be liable to the United States, one year from the date of his breach, for damages

in an amount to be determined under a statutorily prescribed formula. See 42 U.S.C. §254o (b).

When he graduated from medical school in 1982, the defendant failed to comply with the terms and conditions of his service obligation and was determined to be in breach of his scholarship contract as of August 12, 1982. The United States then filed suit against the defendant in the United States District Court to enforce the defendant's contractual obligation to pay damages in lieu of his service obligation. The parties entered into an Agreement for Judgment pursuant to which, on March 20, 1987, judgment entered for the United States for $502,935.15[1] plus interest at the legal rate of 6.04% from the date of judgment. The defendant made payments on the judgment totaling only $4,250.00 and then, on December 13, 1988, filed a petition for relief under Chapter 7 of the Bankruptcy Code.

The dischargeability of an obligation for payment under the NHSC Scholarship Program is governed by 42 U.S.C. §254o (d) (3)[2], which provides as follows:

> (3) Any obligation of an individual under the Scholarship Program (or a contract thereunder) or the Loan Repayment Program (or a contract thereunder) for payment of damages may be released by a discharge in bankruptcy under Title 11 only if such discharge is granted after the expiration of the five-year period beginning on the first date that payment of such damages is required and only if the bankruptcy court finds that nondischarge of the obligation would be unconscionable.

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1 This figure, $502,935.15, is the product of a statutory trebling formula that rendered the defendant liable for an amount equal to three times the sum of his scholarship awards ($85,793.12) and the interest thereon as of the date of judgment ($81,851.93); hence, 3 x (85,793.12 + $81,851.93) = $502,935.15.

2. The parties agree that 42 U.S.C. §254o (d) (3) governs. In his Answer and Counterclaim, the defendant stated that 11 U.S.C. §523 (a) (8) should govern; but the defendant frames the arguments in his memoranda solely in terms of §254o (d) (3).

This section makes dischargeability contingent on two requirements. The parties agree that the first has been satisfied: the defendant filed his bankruptcy petition and would receive his discharge (if at all) after the expiration of the five-year period beginning on the first date that payment of damages was required. The second requirement - that nondischarge of the obligation would be unconscionable - is the primary subject of dispute.

Effect of Agreement for Judgment

Before addressing that issue, the Court must first determine whether 42 U.S.C. §254o (d) (3) applies to this debt at all. That section applies to "any obligation of an individual under the Scholarship Program (or a contract thereunder)." 42 U.S.C. §254o (d) (3). The defendant contends that the Agreement for Judgment between the plaintiff and himself released and discharged him from all claims arising from his scholarship contract obligations. Therefore, the defendant concludes, his obligation under the District Court judgment cannot be characterized as an obligation under the Scholarship Program or under his scholarship agreement. Accordingly, the student loan exceptions to discharge (both 42 U.S.C. §254o (d) (3) and 11 U.S.C. §523 (a) (8))to not apply and his judgment debt is dischargeable.

I reject the defendant's argument. The crucial sentence from the Agreement for Judgment reads as follows:

> The United States and all agencies of the United States release and forever discharge the defendant, William E. Gray, Jr., from all claims, actions or causes of action arising from the contract obligations which are the subject matter of this lawsuit <u>except for any claims, actions or causes of action arising from breach of this agreement.</u>

Agreement for Judgment, par. 6 (emphasis added). It is clear from this sentence and especially from the highlighted portion of it that the United States did not release the defendant from <u>all</u> claims arising from the contract obligations. Some such claims were excepted: those that might

arise from breach of the Agreement for Judgment. In other words, the release was expressly made contingent on defendant's performance of his obligation (detailed in paragraphs 1 through 5 of the Agreement) to pay money to the United States. If the defendant defaulted on that obligation, claims arising from the scholarship contract would remain actionable to the extent necessary to permit the plaintiff to enforce the judgment.

The same result would obtain even if the release clause contained no express exception for claims arising from breach of the Agreement. The defendant, having defaulted on all but $4,250.00 of his obligation under the Agreement to pay at least $167,645.05 plus interest,[3] is in no position to insist on the enforcement of the promises, releases, and discharges given in consideration for his promise to make payments. In view of the defendant's almost complete default on his obligations under the Agreement, the release and discharge given the defendant are of no effect.

Unconscionability of Nondischarge

Having so concluded, the Court must determine whether "nondischarge of the obligation would be unconscionable." 42 U.S.C. §254o (d) (3). The defendant bears the burden of proving that nondischarge would be unconscionable.[4]

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3 The Agreement for Judgment provided that judgment would enter for $502,935.15, but also that if the defendant adhered to the repayment schedule set forth therein, he would be obligated to pay the United States only $167,645.05 (the sum of his scholarship awards and the interest thereon as of the date of judgment) plus interest.

4 This is clear from the language and structure of §254o (d) (3), which is structured such that nondischargeability is the rule and dischargeability is the exception to it, and which provides that a discharge shall enter only upon a finding that "nondischarge of the obligation would be unconscionable." The use of this tortured double-negative, the requirement of a finding as a condition of discharge, and the structure of the subsection can only be explained by concluding that the legislature meant for the debtor to bear the burden of proof. This reasoning is consistent with the settled rule under 11 U.S.C. §523 (a) (8), the Bankruptcy Code's provision regarding the dischargeability of educational loans. The cases under §254o (d) (3), hold that the debtor bears the burden of proof. See Connecticut Student Loan Foundation v. Keenan, 14 C.B.C. 2d 1344, 1347-1348 (Bankr. D. Conn. 1985) and cases cited therein; and Taylor v. Tennessee Student Assistance Corporation, 95 B.R. 550, 552 (Bankr. E.D. Tenn. 1989), quoting from In re Reid, 39 B.R. 24, 26 (Bankr. E.D. Tenn. 1984).

The concept of unconscionability used in §254o (d) (3) does not lend itself to precise definition or easy application. Nonetheless, the courts, following In re Hines, 63 B.R. 731, 734 (Bankr. D.S.D. 1986), agree upon its general parameters, which were well summarized in *In re Green,* 82 B.R. 955 (Bankr. N.D. Ill. 1988):

> In addressing the unconscionability standard of section 294f (g),[5] the Hines court considered two factors. First the plain meaning of the term "unconscionable," which Webster's Dictionary defines as "lying outside the limits of what is reasonable or acceptable" or "shockingly unfair, harsh, or unjust." Webster's Third New International Dictionary 2486 (3d ed. 1981). Second, the court considered the underlying policy of what is unconscionable in a sales setting. (*In re Hines*, 63 B.R. at 736.][6] The Court then stated that unconscionable under section 294f (g) requires a higher standard than a finding of undue hardship under 11 U.S.C. §523 (a) (8) and that what is unconscionable in a bankruptcy context defies precise definition and is better left to discretion of the Bankruptcy Judge. *Id.*

In re Green, 82 B.R. at 959. The vagueness of the "unconscionability" standard thus leaves much to the discretion of the Bankruptcy Judge.

Not surprisingly, therefore, the parties to this proceeding disagree widely about the relevance of various facts to the unconscionability determination; however, they do not disagree about the facts themselves. I find that there are no genuine issues of material fact.

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5 Section 294f (g) (2) of Title 42, like §254o (d) (3), requires a finding by the Bankruptcy Court that "nondischarge of such debt would be unconscionable." Section 294f (g) deals with loans made under a federal student loan insurance program.

6 In Hines, the court set forth three tests of what is unconscionable in a sales setting: whether there was gross inequality of bargaining power between the parties; whether the aggrieved party knew of and comprehended the provision in question; and whether the provision is commercially reasonable according to the mores and business practices of the time and place. In re Hines, 63 B.R. at 736.

To determine whether it would be unconscionable not to discharge the defendant's obligation to the United States, the Court deems it necessary to consider two primary factors: the defendant's ability to repay the debt - including his current income and future earning potential, his ordinary expenses, his debt repayment obligations, and his financial obligations towards dependents - and the nature of the debt itself.

a) The Debtor's Ability to Repay

The defendant has no income other than his salary, but his gross salary is substantial: $90,000.00 per year. He is the Director of Medical Information Services for Astra Pharmaceutical Products, Inc., has been with that company for five years, and has no plans to leave it. He is not underemployed. The Court knows of no impending significant increase or decrease in his salary, but notes from his Statements of Financial Affairs that his salary has increased by $28,400.00 since 1986. The defendant is only thirty-three years old. He is not married and has no dependents, so his financial obligations, other than the obligation to support himself, consist of his obligations to repay two debts. The first is a reaffirmed credit card (Mastercard) debt to the State Street Bank and Trust Company for $5,457.97. The other is a tax arrearage of $27,000.00 owed to the Internal Revenue Service. (The above figures were current as the date of the bankruptcy petition.) The Court has no evidence of the current balance of these debts, their interest rates, or their amortization schedules except that the Debtor indicates that he monthly pays $1,000.00 to the I.R.S. and $200.00 to State Street Bank on their debts.

The defendant has listed annual living expenses, including the payments on his I.R.S. and State Street Bank debt arrearages, of $86,189.00, which would leave him with only $3,911 of net disposable income to apply to his NNSC debt. The listed

expenditures, however, are too high in at least three respects. First, the defendant lists monthly rent of $1,460.00. The Court will take judicial notice that housing prices in the Boston area are high, but not so high that the Debtor could not easily find a safe and comfortable one-bedroom apartment for $850.00 per month. In fact, the defendant could find such an apartment for $700.00 per month without much trouble, but the Court is content to note that the defendant's rent allotment can be cut by $610.00 per month ($7,320.00 per year) without unfair sacrifice.[7]

Second, although the defendant currently pays a total of $14,400 annually to the I.R.S. and State Street Bank on the arrearages he owes them, these payments will not continue indefinitely. Even without increasing his current monthly payments, the defendant will satisfy these obligations in less than three years (including the one year that has passed since this bankruptcy filing). Thereafter, the $14,400 currently dedicated to these debts will be available to pay the debt now in dispute.

Third, the defendant now lists monthly payments to attorneys and accountants of $400.00. After this bankruptcy proceeding is closed, however, such payments will no longer be necessary, and another $4,800.00 per year will become available.

In summary, the defendant, within two years, will be able to channel over $30,000 per year - including $14,400.00 now dedicated to the repayment of other arrearages, $4,800.00 dedicated to professionals' fees, $7,320.00 dedicated to rent, and $3,811.00 of other disposable income - into repayment of his NHSC debt. More than half of that amount is either currently available or will become so within one year.

7 The defendant has submitted no explanation or justification for his extraordinarily high rent, which plainly requires justification.

b) The Debt

These resources, substantial as they are, nonetheless pale in comparison to the NHSC debt, which currently exceeds $550,000.00. Even if the defendant did not have to pay interest on the debt, repayment of the $550,000.00 obligation at the rate of $30,000.00 per year would take more than eighteen years. The debt carries an interest rate of 6.04 percent, but even this low rate, applied to a debt of this magnitude, would require annual interest payments in excess of $30,000.00. In other words, the defendant could spend the rest of his life paying $30,000.00 per year on this obligation and still never reduce the debt below its current level.

This prospect constitutes a seriously depressing disincentive to the defendant, who, because his net disposable income (that is, the $30,000.00 per year that he would apply to his debt) would never inure to his benefit, would have no interest in working for it. Duty alone would not likely motivate many debtors to labor under the burden of debts of this magnitude for their entire working lives.

To keep debtors forever subject to insurmountable debt is in neither the debtor's nor the public's interest. It is not in the debtor's interest because it takes away a good part of the debtor's incentive to work; and it's not in the public's (and the creditors') interest for the same reason: a debtor who can never enjoy any of the fruits of his extra effort will soon cease to make those efforts and to pay his debts. Debtors should have incentive to get up in the morning and go to work. This is the idea behind the Bankruptcy Code's "fresh start" policy and discharge provisions. Section 254o(d) (3) represents a legislative determination that a discharge and a fresh start should not be as freely available with respect to NHSC loans as they are with respect to most other debts in a Chapter 7 case. Rather, NHSC loans should be discharged only to avoid unconscionable results. Still, the degree to which a particular

NHSC obligation would deprive a debtor of incentive to work determines in part whether that obligation is unconscionable.

In this case, the defendant's NHSC obligation is so disproportionate to his ability to repay it that it entirely deprives him of incentive to earn the net disposable income necessary to pay it off. Even with best efforts (assuming that his salary remains at its current level), he could never pay it off and so would never begin to enjoy his net disposable income. This factor alone goes a long way towards persuading the Court that enforcement of the NHSC obligation, at least in its entirety, would be unconscionable.

A second factor makes that conclusion unavoidable: specifically, that the size of the debt is a function of a statutory trebling formula. Section 254o(b) provides that an NHSC loan recipient who fails to complete his service obligation shall be liable to the United States for an amount equal to three times the amounts loaned to him plus interest.[8] 42 U.S.C. §254o(b) (1) (A). Therefore, although the defendant had received only $85,793.12 in scholarship loans and had become obligated for another $81,851.93 in interest by the judgment date, for a total debt of $167,645.05, judgment entered for three times that amount, $502,935.15.

Section 254o (b)'s triple damages provision is a valid liquidated damages clause,[9] not an unenforceable penalty. Nonetheless, the very existence of §254o (d) (3), the subsection on dischargeability, indicates that Congress foresaw that the trebling provision might sometimes work an unconscionable result.

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8 It also gives the loan recipient credit for whatever portion of his service obligation he may have satisfied. The defendant in this case did not serve at all.

9 See United States v. Turner, 360 F. Supp. 1323, 1332-1333 (E.D.N.Y. 1987); United States v. Hayes, 633 F. Supp. 1183, 1185-1187 (M.D.N.C. 1986); United States v. Fowler, 659 F. Supp. 624, 625 (N.D. Cal. 1987), aff'd without opinion 849 F.2d 1476 (9th Cir. 1988); United States v. Padavano, 664 F. 2d 28, 30 (D. Me. 1987); and United States v. Swanson, 618 F. 2d 1231, 1242-1244 (D.C. Mich. 1985).

This is one such instance. The defendant twice failed to pass the medical boards and so could not practice as a licensed physician in satisfaction of his service obligation.[10] That being the case, it seems unreasonably harsh to enforce the triple damages provision in these circumstances. Of course, the defendant did bargain for the triple damages provision knowing that he might not be able to satisfy the service obligation, so were he able to pay it off, the Court would deny the discharge he seeks. But where the defendant cannot service the tripled debt, and where he incurred it because he was unable to satisfy the service obligation as a physician, the Court concludes that enforcement of the full obligation would be unconscionable.

Nonetheless, enforcement of a portion of the obligation would not be unconscionable.[11] The defendant can well afford to repay some portion of the debt, so it would be as unconscionable to discharge the debt entirely as not to discharge it at all.

One who seeks equity must do equity and cannot insist on a windfall at the other's expense. See, for example, El Peso Natural Gas Co. v. Western Bldg. Assoc., 675 F. 2d 1135, 1142 (10th Cir.

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10 The Court has no evidence on whether the defendant could have satisfied his service obligation without a license to practice medicine.

11 Several Bankruptcy Courts have seen fit, when faced with a complaint to discharge a student loan, to discharge only a portion of the loan. See In re Love, 33 B.R. 753 (Bankr. E.D. Va. 1983) (denying discharge, but limiting repayment to unpaid principal and delaying the commencement of the repayment schedule); In re Albert, 25 B.R. 98 (Bankr. N.D. Ohio 1982) (denying discharge, but reducing the liability by the amount of accrued interest and modifying repayment schedule); In re Brown, 18 B.R. 219 (Bankr. D. Kan. 1982) (same); In re Archie, 7 B.R. 715 Bankr. E.D. Va. 1980) (denying discharge, but revising repayment schedule); Matter of Hemmen, 7 B.R. 63 (Bankr. N.D. Ala. 1980) (modifying repayment schedule); In re Littell, 6 B.R. 85, 89 (Bankr. D. Or. 1980) ("Instead of the all or nothing approach, the courts should consider whether only part of the debt should be nondischargeable and what monthly payment the debtor could afford. Id.) This Court believes that the authority to grant a partial discharge is part of its authority as a court of equity dealing with a request for equitable relief - a discharge for unconscionability. The ability to craft an equitable remedy in the form of a partial discharge under 42 U.S.C. §254o (d) (3) is well within the Court's authority under 11 U.S.C. §105 (a).

1982) ("A party seeking equitable relief must be prepared to give in return that which is just and equitable."). The defendant can fairly and reasonably be required to repay the principal amount of his NHSC scholarship awards with interest. This does not give the United States the full benefit of its bargain, to which it would normally be entitled, but it does at least compensate the United States for its monetary investment in this contract. It returns the United States to the position it was in before the contract, in effect rescinding the agreement because of the inability of the defendant to perform.

In this case, principal and interest as of the date of the District Court judgment (March 20, 1987) totaled $167,645.05. With simple interest at the rate of 6.04 percent from March 20, 1987, the amount of the debt would today be $198,022.33. Against this amount, the defendant should be given credit for the $4,250.00 he has already paid, which would reduce the balance to $193,772.33. The defendant could amortize a debt of that size (accruing interest at 6.04 percent per annum) at the rate of $30,000.00 per year in approximately nine years. This would still be a sizable burden, but not an undue burden and certainly not an unfair or unconscionable one.

Conclusion and Order

With respect to all three motions for summary judgment, there are no issues of material fact, and judgment should enter as a matter of law. The judgment that should enter on both the United States' claim and the defendant's counterclaim is a declaration that a $193,772.33 portion of the defendant's NHSC scholarship debt to the United States is nondischargeable and that the remainder of the debt is discharged.[12] The United States' motion for a summary judgment and the defendant's second motion for summary judgment are accordingly allowed in part and denied in part. The

defendant's first motion for summary judgment, which sought judgment solely on the basis of the defendant's argument that §254o (d) (3) did not apply to the debt in question, is denied. A separate judgment will enter accordingly.

At Boston, this 20th day of March, 1990.

Carol J. Kenner
United States Bankruptcy Judge

cc: Guy Moss, Esq., Debtor's Counsel
Ann M. D'Arpino, Esq., Special
Assistant U.S. Attorney

12 The Court will not require that the defendant repay the debt in nine years, though he may do so. Rather, the Court merely reinstates the more lenient payment schedule that he and the United States agreed on in paragraphs 2 (c) and 2 (d) of their Agreement for Judgment of March 13, 1987. In recognition of the temporary burden imposed by the defendant's other repayment obligations, the Court orders that monthly payments (and the accrual of interest) under paragraphs 2 (c) and 2 (d) not resume until January 15, 1991.